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C O N F I D E N T I A L SECTION 01 OF 02 YEREVAN 000316

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TAGS: EAGR ECON ETRD AM

SUBJECT: KRUSCHEV'S "VIRGIN LANDS" ALL OVER AGAIN?: NEW ARMENIAN PRESIDENT PUSHING IMPORT SUBSTITUTION PLANS FOR GRAIN

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Classified By: CDA JOSEPH PENNINGTON. REASON 1.4 (B/D)

SUMMARY

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¶1. (C) President Serzh Sargsian has been calling for a new national program to make Armenia self-sufficient in the production of wheat and corn. Emboff's discussions since mid-March with senior Agriculture Ministry, regional, and local officials have made clear that the GOAM is already actively developing plans and looking for new lands where these grains could be grown. This suggests that Sargsian has reached first for a statist, command-and-control government solution to the political problem of recent increases in grain and other commodity prices that have delivered a significant shock to the Armenian economy. GOAM officials have indicated they would seek assistance from aid agencies and multilateral lending institutions. This proposal is worrisome on two levels: on purely economic grounds and for what it says about the new president's policy instincts and intellectual toolbox. END SUMMARY.

THE RETURN OF CENTRAL PLANNING?

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¶2. (C) In mid-March then Prime Minister (and President-Elect) Serzh Sargsian reportedly proposed that the GOAM should finance a project to make Armenia self-sufficient in the production of wheat and corn. Called the "Increased Wheat and Corn Production in Armenia" initiative and originally expected to fade into oblivion, it is an idea that has thus far refused to die. Minister of Agriculture Lokian confirmed in late March to the resident USDA director that Sargsian is very serious about pursuing it, but provided no estimate of its likely cost. Lokian inquired, however, about possible USG assistance to bring it into being.

¶3. (C) In the last week of March several local officials told emboffs that they had been occupied in recent weeks with identifying "suitable" plots of land where wheat and corn could be grown. It is not clear whether the GOAM plans to divert land from other agricultural uses, would cultivate fallow land, or might clear other acreage for this purpose (in a country with just eight percent forest cover).

¶4. (C) Beyond the question of whether a state should intervene so directly in the economy, there are other serious drawbacks to this plan. Armenia simply lacks sufficient arable land to produce adequate amounts of wheat and corn. Any major expansion of wheat and corn production would require intensive irrigation, further straining available

water resources. Also, Armenia is a country of small subsistence farms, while wheat and corn production requires large farms to be cost-effective. Armenia's rocky and mountainous topography leaves comparatively little land area that seems suitable for large-scale commercial grain farming. This initiative would also work directly against USDA's CARD, MCC's ACDI/VOCA and other donor-funded rural-development programs that seek to encourage cultivation of higher-margin fruits and vegetables rather than low-margin commodity crops.

RESPONSE TO WORLD PRICES?

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¶5. (C) Recent increases in world prices of wheat and corn have had a significant impact on the Armenian economy, particularly in the price of bread. This self-sufficiency initiative appears to be Sargsian's response to the destabilizing effects of price increases on the world market.

Sargsian may also view current market prices as presenting an opportunity for growers to benefit from those prices. Nonetheless, Armenian agricultural contacts have described the proposal as seriously flawed and a potential disaster for Armenian agriculture and the economy.

¶6. (C) The plan also overlooks a potentially greater influence on domestic food prices: government-protected monopolies on the import of many food items. A single oligarch (and MP), Samvel "LFik Samo" Alexanian, holds a de facto monopoly on the import of sugar and wheat, and controls an estimated 80 percent of the market for sunflower-seed oil and butter. While world prices for wheat and corn are currently at historic highs, the lack of competition in the provision of these staples on the domestic market clearly does not help to keep prices down.

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COMMENT

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¶7. (C) Among independent Armenia's early economic achievements in the 1990s -- well ahead of most of its fellow former Soviet Republics -- was the complete privatization of state-owned agricultural lands. Sargsian's proposal appears aimed at putting state direction back into the heart of the agricultural economy. While Sargsian and his advisers typically say most of the right things about political and economic reform, a move to seek self-sufficiency in the production of nearly any commodity - especially of such low-margin ones as wheat and corn - would be a major retreat from those promises. It is unlikely that Armenia could produce sufficient amounts of these staples, and an attempted effort could come at a high cost to the Armenian economy, especially if government mandates divert producers away from other critical and higher-margin crops. Aside from the economic lunacy of this "back to the future" proposal, this initiative serves as a pointed reminder of the deficiencies of Sargsian's professional background as preparation for running the Armenian government. We hope that this will prove a short-lived "rookie mistake," and that more economically literate advisers will soon steer Sargsian's policy impulses in a more constructive direction. Otherwise, we fear Sargsian runs the risk of compounding his political crisis with misguided economic management.

FRAZIER